

**CONSOLIDATED FINANCIAL STATEMENTS  
AND REPORT OF  
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS  
SHOREBANK CORPORATION AND SUBSIDIARIES  
DECEMBER 31, 2003 AND 2002**

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**REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS**

Shareholders and Board of Directors  
ShoreBank Corporation

We have audited the accompanying consolidated balance sheet of ShoreBank Corporation and Subsidiaries (the "Corporation") as of December 31, 2003, and the related consolidated statements of income, shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The consolidated financial statements of ShoreBank Corporation and Subsidiaries, as of and for the year ended December 31, 2002, were audited by other auditors, whose report dated April 11, 2003, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ShoreBank Corporation and Subsidiaries as of December 31, 2003, and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

*Grant Thornton LLP*

Chicago, Illinois  
March 12, 2004

**ShoreBank Corporation and Subsidiaries**  
**CONSOLIDATED BALANCE SHEETS**  
**December 31,**  
**(In thousands)**

<b>ASSETS</b>	<u>2003</u>	<u>2002</u>
Cash and due from banks	\$ 28,375	\$ 25,585
Federal funds sold	975	3,020
Total cash and cash equivalents	29,350	28,605
Securities available-for-sale	489,543	445,994
Securities held-to-maturity	31,162	25,898
Federal Home Loan Bank stock	22,710	16,451
Other investments	1,825	1,319
Loans, net	886,235	778,330
Land, buildings and equipment, net	22,256	23,326
Accrued interest receivable	8,557	8,626
Goodwill	8,118	8,118
Core deposit intangible	2,004	2,513
Bank-owned life insurance	3,508	3,346
Other assets	10,589	10,140
<b>TOTAL ASSETS</b>	<u><b>\$ 1,515,857</b></u>	<u><b>\$ 1,352,666</b></u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
<b>Deposits</b>		
Non-interest bearing	\$ 94,772	\$ 89,901
Interest bearing	950,555	872,083
Total deposits	1,045,327	961,984
Federal funds purchased	29,100	29,652
Notes payable	36,896	24,435
Other borrowings	295,204	225,950
Accrued interest payable and other liabilities	16,775	19,244
Total liabilities	1,423,302	1,261,265
<b>Commitments and contingencies</b>		
-		
<b>Shareholders' equity</b>		
Preferred stock	3,318	3,620
Common stock	14	14
Additional paid-in capital	62,376	63,442
Retained earnings	25,806	19,093
Accumulated other comprehensive income	1,041	5,232
Total shareholders' equity	92,555	91,401
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<u><b>\$ 1,515,857</b></u>	<u><b>\$ 1,352,666</b></u>

The accompanying notes are an integral part of these statements.

**ShoreBank Corporation and Subsidiaries**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**Years ended December 31,**  
**(In thousands, except per share amounts)**

	2003	2002
Interest and dividend income		
Loans, including fees	\$ 59,819	\$ 57,813
Securities		
Taxable	21,529	26,994
Tax exempt	3,295	1,805
Federal funds sold and other	229	153
<b>Total interest and dividend income</b>	<b>84,872</b>	<b>86,765</b>
Interest expense		
Deposits	21,578	26,736
Borrowed funds	13,102	12,724
<b>Total interest expense</b>	<b>34,680</b>	<b>39,460</b>
<b>Net interest income</b>	<b>50,192</b>	<b>47,305</b>
Provision for loan losses	5,389	3,966
<b>Net interest income after provision for loan losses</b>	<b>44,803</b>	<b>43,339</b>
Non-interest income		
Deposit service fees	6,089	6,444
Gain on sale of securities	2,106	1,697
Real estate projects, net	159	210
Consulting income	7,126	7,579
Other non-interest income	3,574	2,492
<b>Total non-interest income</b>	<b>19,054</b>	<b>18,422</b>
Non-interest expense		
Salaries, wages and employee benefits	30,758	28,791
Occupancy expense	3,121	3,175
Equipment and data processing expense	3,658	3,655
Amortization of core deposit intangible	509	510
Provision for impairment of real estate projects	797	468
Uncollectible advances to real estate projects	739	1,140
Professional fees	2,195	990
Marketing expense	1,427	1,219
Other non-interest expense	11,774	12,198
<b>Total non-interest expense</b>	<b>54,978</b>	<b>52,146</b>
<b>Income before income taxes</b>	<b>8,879</b>	<b>9,615</b>
Provision for income taxes	1,837	2,891
<b>NET INCOME</b>	<b>\$ 7,042</b>	<b>\$ 6,724</b>
Basic earnings per common share	\$ 444.91	\$ 422.98
Diluted earnings per share	\$ 437.62	\$ 416.08

The accompanying notes are an integral part of these statements.

ShoreBank Corporation and Subsidiaries  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**  
Two years ended December 31, 2003  
(In thousands, except per share amounts)

	Preferred stock	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
Balance at January 1, 2002	\$ 3,998	\$ 14	\$ 63,442	\$ 12,715	\$ 1,494	\$ 81,663
Comprehensive income						
Net income	-	-	-	6,724	-	6,724
Net increase in fair value of securities available-for-sale, net	-	-	-	-	3,738	3,738
Total comprehensive income						10,462
Cash dividends declared on common stock (\$10.00 per share)	-	-	-	(155)	-	(155)
Cash dividends declared on preferred stock	-	-	-	(191)	-	(191)
Redemption of preferred stock	(378)	-	-	-	-	(378)
Balance at December 31, 2002	3,620	14	63,442	19,093	5,232	91,401
Comprehensive income						
Net income	-	-	-	7,042	-	7,042
Net decrease in fair value of securities available-for-sale, net	-	-	-	-	(4,191)	(4,191)
Total comprehensive income						2,851
Cash dividends declared on common stock (\$10.00 per share)	-	-	-	(155)	-	(155)
Cash dividends declared on preferred stock	-	-	-	(174)	-	(174)
Redemption of common stock	-	-	(1,066)	-	-	(1,066)
Redemption of preferred stock	(302)	-	-	-	-	(302)
Balance at December 31, 2003	<u>\$ 3,318</u>	<u>\$ 14</u>	<u>\$ 62,376</u>	<u>\$ 25,806</u>	<u>\$ 1,041</u>	<u>\$ 92,555</u>

The accompanying notes are an integral part of this statement.

**ShoreBank Corporation and Subsidiaries**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Years ended December 31,**  
**(In thousands)**

	2003	2002
<b>Cash flows from operating activities</b>		
Net income	\$ 7,042	\$ 6,724
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	5,389	3,966
Depreciation and amortization	2,244	2,043
Uncollectible advances to real estate projects	739	1,140
Amortization of core deposit intangible	509	510
Gain on sale of securities	(2,106)	(1,697)
Net discount accretion on securities	(3,876)	(2,558)
Federal Home Loan Bank stock dividends	(1,199)	(572)
Deferred income taxes	(1,652)	1,418
Provision for impairment loss on premises and equipment	69	250
Provision for impairment of real estate projects	797	468
Increase in cash surrender value of bank-owned life insurance	(162)	(147)
Change in assets and liabilities		
Accrued interest receivable	69	192
Accrued interest payable	(600)	13
Other assets	3,154	(1,843)
Other liabilities	(2,205)	2,910
<b>Net cash provided by operating activities</b>	<b>8,212</b>	<b>12,817</b>
<b>Cash flows from investing activities</b>		
Activity in securities available-for-sale		
Sales and calls	334,952	281,822
Maturities and prepayments	187,896	221,322
Purchases	(567,490)	(451,335)
Activity in securities held-to-maturity		
Maturities and prepayments	411	1,910
Purchases	(5,573)	(13,568)
Purchases of Federal Home Loan Bank stock	(5,060)	(5,104)
Change in other investments	(506)	413
Loan originations and payments, net	(113,294)	(83,436)
Capital expenditures, net	(1,741)	(1,216)
<b>Net cash used in investing activities</b>	<b>(170,405)</b>	<b>(49,192)</b>

**ShoreBank Corporation and Subsidiaries**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED**  
**Years ended December 31,**  
**(In thousands)**

	2003	2002
Cash flows from financing activities		
Net change in deposits	\$ 83,343	\$ 25,549
Advances on notes payable	16,000	8,178
Repayments on notes payable	(391)	(7,325)
Increase in deferred loan costs	(207)	(263)
Net change in borrowings under lines of credit	(3,450)	2,519
Proceeds from Federal Home Loan Bank advances	57,450	64,850
Repayments of Federal Home Loan Bank advances	(46,990)	(32,000)
Net change in Federal funds purchased	(552)	(23,648)
Net change in reverse repurchase agreements	60,500	-
Net change in treasury, tax and loan note payable	(1,706)	1,850
Preferred stock dividends	(174)	(191)
Common stock dividends	(155)	(155)
Redemption of preferred stock	-	(76)
Redemption of common stock	(730)	-
	<u>162,938</u>	<u>39,288</u>
Net cash provided by financing activities		
	745	2,913
Change in cash and cash equivalents		
	<u>28,605</u>	<u>25,692</u>
Cash and cash equivalents at beginning of year		
	<u>\$ 29,350</u>	<u>\$ 28,605</u>
Cash and cash equivalents at end of year		
Supplemental disclosures of cash flow information		
Cash paid during the year for		
Interest	\$ 35,280	\$ 39,447
Income taxes	2,100	2,100
Supplemental non-cash disclosures		
Series B1 preferred stock exchanged for notes payable	\$ 107	\$ 107
Series D preferred stock exchanged for notes payable	138	137
Series B2 preferred stock exchanged for notes payable	57	58
Real estate acquired through foreclosure	(57)	473
Due to broker for purchases of securities	-	(7,992)
Due to shareholders for redemption of common stock	(336)	-

The accompanying notes are an integral part of these statements.

**ShoreBank Corporation and Subsidiaries**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2003 and 2002**  
**(Table amounts in thousands)**

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**NOTE A - NATURE OF OPERATIONS**

ShoreBank Corporation (which includes its subsidiaries and is referred to collectively as the "Corporation") is America's first and leading community development and environmental banking corporation. The Corporation is committed to building vibrant communities by providing financial services and information to create economic equity and a healthy environment. The Corporation is a pioneering leader developing models and services that catalyze economic opportunity, social equity and environmental sustainability. As a business that focuses on creating social and environmental change, the Corporation provides innovative financial services and knowledge. The Corporation believes that investing in individuals and their communities enables them to leverage their entrepreneurship and hard work to create wealth, revitalize neighborhoods, and meet both environmental and economic needs.

The Corporation is a multi-bank holding company organized under the laws of the State of Illinois. The Corporation is headquartered in Chicago, Illinois and has banks and affiliated not-for-profit entities in Chicago, Cleveland, Ohio, Detroit, Michigan, Ilwaco, Washington, and Portland, Oregon. Additionally, the Corporation offers business development services in the Upper Peninsula of Michigan and consulting services around the world.

The Corporation's banking subsidiaries, ShoreBank, ShoreBank, Cleveland, and ShoreBank Pacific, provide a broad range of financial services and offer various types of financial consulting services to customers in their market areas. The banks' primary deposit products are checking, savings and time deposit accounts, and their primary lending products are single and multi-family residential mortgage, commercial, and faith based loans.

The Corporation's wholly-owned subsidiaries are as follows:

- ShoreBank (a bank organized under the laws of the State of Illinois);
- ShoreBank Capital Corporation (a specialized small business investment company (SBIC) licensed by the SBA under Section 301);
- ShoreBank Development Corporation, Chicago (rehabilitation, construction and resale of residential properties for the benefit of low and moderate income families);
- ShoreBank Advisory Services, Inc. ("SAS") (consulting for programs designed to promote community welfare through economic rehabilitation and development of underinvested low income communities, both domestically and internationally);
- Shorebank Cleveland Corporation (a bank holding company, which wholly-owns ShoreBank, Cleveland and ShorePlace Development Corporation, a real estate development company);
- ShoreBank Development Corporation, Detroit (a real estate development company);

**ShoreBank Corporation and Subsidiaries**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**  
**December 31, 2003 and 2002**  
**(Table amounts in thousands)**

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**NOTE A - NATURE OF OPERATIONS - Continued**

- ShoreBank Pacific Corporation (a bank holding company, which wholly-owns ShoreBank Pacific);
- ShoreCap Management, Ltd. (provides investment management services to ShoreCap International, Ltd., a specialized investment company); and
- Shorebank Capital Trusts I, II and III.

Certain employees and directors of the Corporation sit on the boards of directors of the Corporation's not-for-profit affiliates, which include: ShoreBank Enterprise, Detroit; ShoreBank Enterprise, Cleveland ("SEC"); ShoreBank Enterprise Group, Pacific; ShoreBank Neighborhood Institute ("SNP"); and Northern Initiatives. These entities seek to promote the social and economic welfare of low-to-moderate income residents in the Corporation's priority communities of Chicago, Cleveland, Detroit, the Upper Peninsula of Michigan, and the coast of the Pacific Northwest. Additional related parties include: TNI Development Corporation, a for-profit subsidiary of SNI established to develop residential properties for the benefit of low-to-moderate income families; Shore Staffing Works, another for-profit subsidiary of SNI that provides temporary and permanent employment services; and ShoreBridge Capital, a for-profit limited liability company partially owned by SEC that provides mezzanine financing to companies in and around Cleveland. The Corporation does not have any ownership interest in these entities. Accordingly, the accounts of these affiliated entities are not consolidated with those of the Corporation.

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**NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Principles of Consolidation***

The consolidated financial statements include the accounts of the Corporation and all of its wholly-owned subsidiaries. Significant intercompany balances and transactions have been eliminated in consolidation.

***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the reporting period. The allowance for loan losses, fair values of financial instruments, goodwill, core deposit intangible, fair value of unconsolidated partnership interests and the status of contingencies are particularly subject to change in the near term. Actual results could differ from those estimates.

ShoreBank Corporation and Subsidiaries  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**  
 December 31, 2003 and 2002  
 (Table amounts in thousands)

**NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

*Comprehensive Income*

Comprehensive income is defined as the change in equity of a business enterprise from transactions and other events from non-shareholder sources. Comprehensive income includes net income and other changes in equity that bypass the statement of income and are reported as a separate component of shareholders' equity. For the years ended December 31, 2003 and 2002, other comprehensive income includes only one component, the change in unrealized gains on available-for-sale investment securities.

Other comprehensive income for the years ended December 31 is as follows:

	<u>2003</u>	<u>2002</u>
Unrealized holding (losses) gains on securities available-for-sale	\$(4,867)	\$7,725
Less reclassification adjustment for gains realized in net income	<u>2,106</u>	<u>1,697</u>
Net unrealized (losses) gains	(6,973)	6,028
Income tax effect	<u>(2,782)</u>	<u>2,290</u>
Other comprehensive (loss) income	<u>\$(4,191)</u>	<u>\$3,738</u>

*Securities*

Securities are classified as available-for-sale when management may decide to sell those securities in response to changes in market interest rates, liquidity needs, changes in yields on alternative investments and for other reasons prior to maturity. They are carried at fair value.

Unrealized gains and losses on securities available-for-sale are a component of comprehensive income and included as a separate component of shareholders' equity, net of income taxes. Realized gains and losses on disposition are based on the net proceeds and the adjusted carrying amount of the securities sold, using the specific identification method. Securities are written down to fair value when a decline in fair value is not temporary. Interest income includes amortization and accretion of purchase premiums and discounts.

Securities are classified as held-to-maturity when management has the positive intent, and the Corporation has the ability to hold, those securities to maturity. They are stated at cost, adjusted for amortization of premiums and accretion of discounts.

**ShoreBank Corporation and Subsidiaries**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**  
**December 31, 2003 and 2002**  
**(Table amounts in thousands)**

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**NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

*Securities - Continued*

Federal Home Loan Bank stock, which is a restricted equity security, is carried at cost. Other investments consist primarily of investments in mezzanine loan funds, which are carried at cost, and an investment in a mutual fund, which is carried at fair value.

*Loans*

Loans are stated at the principal amount outstanding, net of unearned interest and deferred loan fees and costs. Loan fees and direct loan origination costs are deferred and amortized over the term of the loan as a yield adjustment.

Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. In all cases, loans are placed on non-accrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not received for loans placed on non-accrual and impaired loans is reversed against interest income. Interest received on such loans is accounted for on the cash basis or cost recovery method, until the loans qualify for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

*Allowance for Loan Losses*

The allowance for loan losses is a valuation allowance for probable unidentified credit losses, increased by the provision for loan losses and decreased by charge-offs, net of recoveries. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the loan portfolio, information about specific borrower situations and estimated collateral valuations, economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that is charged off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

**ShoreBank Corporation and Subsidiaries**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**  
**December 31, 2003 and 2002**  
**(Table amounts in thousands)**

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**NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

***Allowance for Loan Losses - Continued***

A loan is impaired when full payment under the loan terms is not expected. Multi-family mortgage, church, commercial and commercial real estate loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance may be allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral, including United States Small Business Administration ("SBA") guarantees. Large groups of smaller-balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment and, accordingly, they are not separately identified for impairment disclosures.

***Revenue Recognition and Deferred Revenue***

Fees for consulting services are recognized on the accrual basis at the time services are rendered after an estimated provision for unbillable amounts. Fees received in advance of services performed are recorded as deferred revenue.

***Real Estate Held for Development and Sale***

Rehabilitation and construction costs, and other project-related costs, are capitalized as project costs. Project fee revenues are recognized under the percentage-of-completion method for long-term construction contracts. Under this method, revenues are recognized when there is available evidence of the ultimate proceeds and when the cost of completion estimates are reasonably dependable. Losses on projects are recognized at the time that such losses can be reasonably estimated. It is reasonably possible that these estimates of revenue and losses could change in the near term and the effect of the change could be material.

Real estate development projects are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of assets may not be recoverable. The Corporation determines recoverability by comparing current and future levels of income and cash flows, as well as the fair market value of the assets, to the carrying amount.

During 2003 and 2002, the Corporation recorded a provision for impairment of real estate projects of \$797,000 and \$468,000, respectively, primarily due to changes in market conditions in Chicago.

